

The Bottom-Line: Breaking Down Management Fees

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Breaking Down Management Fees

Scope & Limitations: Investment Management Fees Are Not One-Size-Fits-All

- This presentation provides a **high-level overview** of traditional and private investment fee structures.
- It is **not exhaustive** and does not capture all variations across managers or strategies.
- Fee structures in private markets are **complex and evolving**, and are challenging to understand even for the most experienced investors.
- Each investment should be evaluated **case-by-case** to ensure fees are competitive, transparent, and aligned with investor goals.

Breaking Down Management Fees

No One Loves Paying the Bills, But Management Fees Should Work for the Investor



Management fees should:

- **Cover the costs** required to deploy the strategy (*salaries, technology, research, travel, office*)
- Most importantly, **align interests** between investors and asset managers

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Traditional Management Fees (“Fixed” or Ad Valorem)

What it means:

- Fees charged as a **percentage of assets under management (AUM)**
- Commonly quoted in **basis points (bps)** (e.g., **0.50% = 50 bps**)
- Incentivizes managers to **grow and retain assets**

Example: $\$10,000,000 \text{ AUM} \times 0.50\% = \$50,000 \text{ per year}$

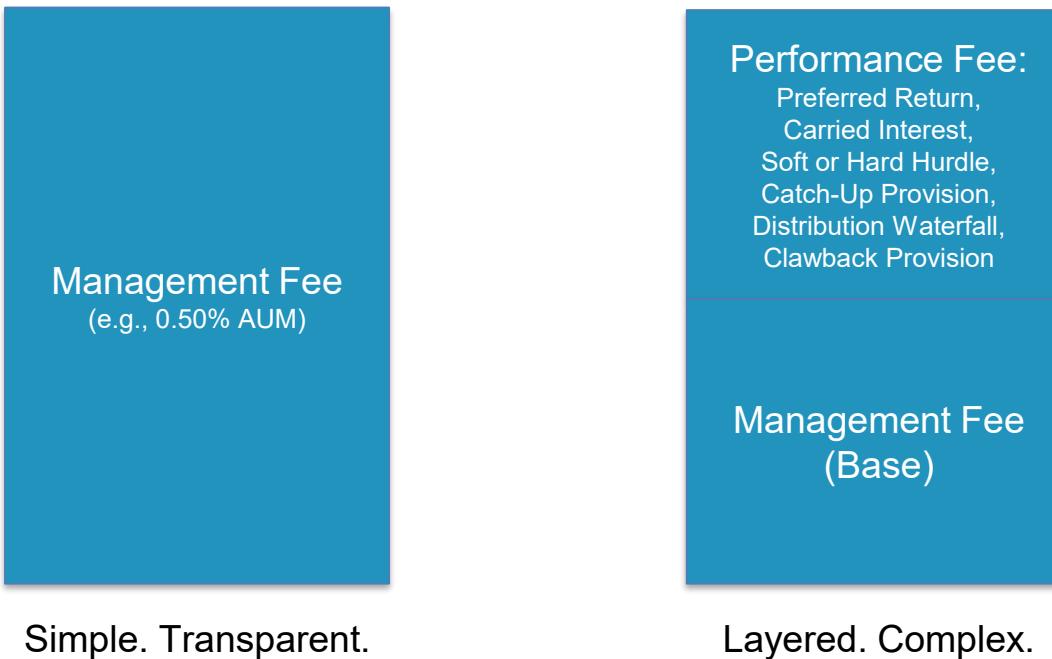
Why fees vary:

- Management fees differ by **asset class and strategy**
- Investors should assess whether a fee is **competitive and appropriate**
- For example, international equity strategies often have higher fees than domestic equity due to added **geopolitical, economic, and cultural analysis**.

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Private Investment Manager Fees: A Different Beast

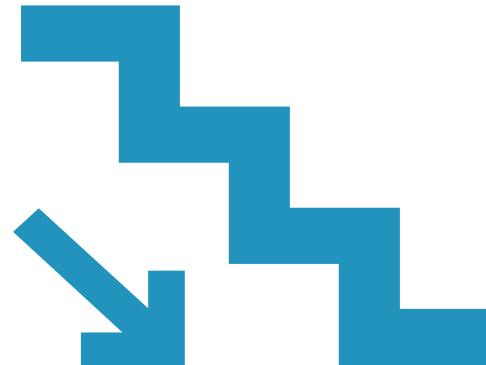
Private investment fees are multi-layered. It is important that investors understand their fee structures.



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Base Management Fee in Private Investments

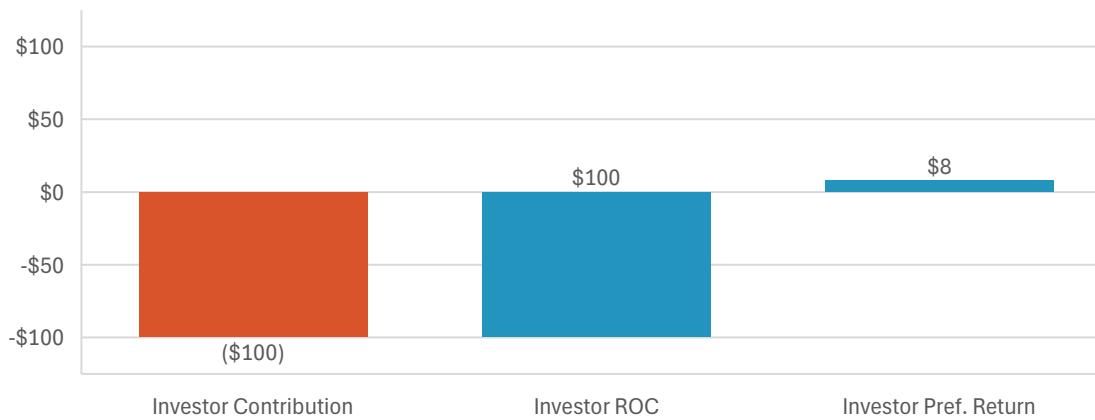
- Include a **fixed base fee**, separate from the performance-based fee
- **1.0%–2.5% of committed capital**, varying widely by asset class and strategy type (Real Estate, Private Equity, Private Credit, Infrastructure)
- Most funds apply a **step-down after the investment period**
 - Fees reduced or charged on remaining invested capital
- Base management fees are typically paid until the fund is fully dissolved.



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Performance-Based Fees: Preferred Return (Hurdle Rate)

- **Preferred Return** is the annual return that must be achieved before the asset manager earns performance-based compensation.
- Typically **7%–8%**, net of management fees and expenses.
- **Simplified example:**
 - Investor commits **\$100 million** to the fund
 - After one year, the fund sells **60% of its investments for \$125 million**
 - Proceeds are first used to return **\$100 million of invested capital** and an **\$8 million preferred return** to the investor



For illustrative purposes only. Past performance is no guarantee of future results.

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Performance-Based Fees: Carried Interest

- **Carried Interest** is performance-based compensation paid to the asset manager **after** the investor's preferred return has been met.



- A common structure is an **80/20 split**, where **80% of profits** above the preferred return are allocated to investors and **20%** to the asset manager.

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Performance-Based Fees: Soft and Hard Hurdle Rates

Hard Hurdle Rate:

- Manager earns carried interest **only on profits above** the preferred return (hurdle rate).
- **Investor-friendly:** Investors retain **all profits below** the hurdle rate.

Soft Hurdle Rate

- Once the hurdle rate is met, the manager earns carried interest **on all profits**, including those below the preferred return.
- **Manager-friendly:** The manager collects carried interest on **total profits**, rather than only profits in excess of the hurdle rate.

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Performance-Based Fees: Catch-Up Provision

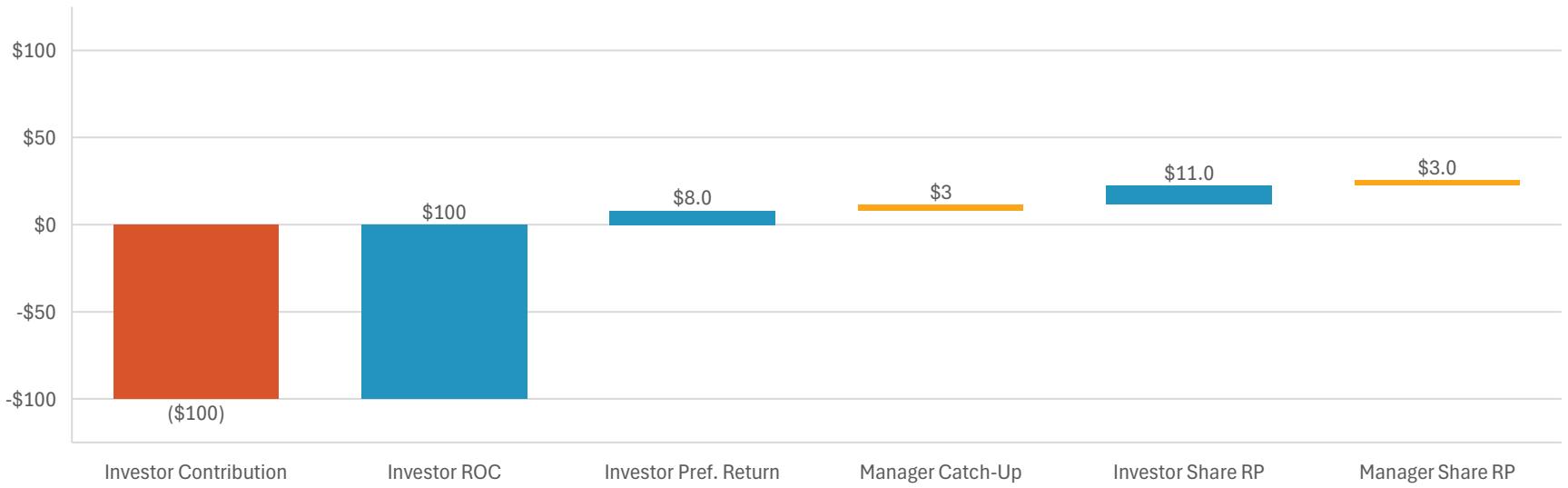
- **Catch-Up Provision** defines how profits are allocated **after** the investor's preferred return has been satisfied and before the standard carried interest split applies.
- Catch-up rates typically range from **50% to 100%**. In many structures, the manager is “caught up” at **100%** until it reaches full carried interest entitlement (e.g., **20% of aggregate profits**).



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Performance-Based Fees: Bringing It All Together

- Simplified example continued:
 - Investor commits **\$100 million** to the fund
 - After one year, the fund sells **60% of its investments for \$125 million**
 - Proceeds are first used to return **\$100 million of invested capital** and an **\$8 million preferred return** to the investor
 - The manager is then **caught up to a 20% share of profits** above the preferred return and receives **\$3 million**
 - Remaining profits (RP) are split **80% to the investor / 20% to the manager**, resulting in distributions of **\$11 million** to the investor and **\$3 million** to the manager



For illustrative purposes only. There is no guarantee that other clients will experience similar results as various factors can cause actual outcomes to differ materially.

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Performance-Based Fees: Clawback Provision

- **Clawback Provision** gives investors the right to **recapture a portion of performance-based compensation** previously paid to the manager.
- Clawback provisions are **standard** and it is uncommon for a private fund agreement **not** to include one.
- Clawbacks typically apply when a fund realizes **early gains** and pays carried interest, but later incurs **losses** that reduce overall returns below agreed thresholds.

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Performance-Based Fees: Distribution Waterfall

- **Distribution Waterfall** outlines the order and timing of profit distributions between investors and the asset manager.

European-Style Waterfall (Whole-Fund):

- Manager earns carried interest **only after investors recover all capital + preferred return**.
- **Investor-friendly:** reduces risk of manager being overpaid on early winners if later deals lose money.

American-Style Waterfall (Deal-by-Deal):

- Manager earns carried interest **after each successful deal**, even if investors haven't recovered all capital.
- **Manager-friendly:** faster liquidity and stronger manager incentives.

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Performance-Based Fees: Cheat Sheet for Trustees

Preferences for Investors and Managers	Investor	Manager
Base Management Fee	Lower	Higher
Carried Interest	Lower	Higher
Hurdle Rate/Preferred Return	Higher	Lower
Hurdle Rate Type	Hard	Soft
Catch-Up Provision	Lower	Higher
Distribution Waterfall	European	American
Clawback Provision	Yes	No

Key Takeaways

Private investments typically include both a **management fee** and a **profit-sharing component**.

The **profit-sharing structure** is **multi-layered** and **complex**, with a wide variety of configurations found in the market.

Before committing to an investment, investors should fully understand **how fees are calculated and how profits will be shared**.

Whenever possible, **fee terms should be negotiated** to ensure they **align the interests of both the investor and the manager**.

Questions

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